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**DEMOCRATICALLY ELECTED SOCIALIST
PRESIDENTS AND FREE-MARKET REFORMS: A
POLITICAL ECONOMY EXAMINATION**

by

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March 2004

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DEMOCRATICALLY ELECTED SOCIALIST PRESIDENTS AND FREE-MARKET REFORMS: A POLITICAL ECONOMY EXAMINATION

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ABSTRACT

Left-of-center parties are rhetorically against liberalizing markets, but historical evidence proves otherwise under certain circumstances. The United States is vitally interested in the democratic and economic success of developing countries, as stated in United States national security strategy. This thesis uses economic institutionalism to examine the occasions on which left-of-center presidents successfully implemented neoliberal economic reforms. Case studies of Chile under President Patricio Aylwin and Brazil under President Fernando Henrique Cardoso are used as evidence.

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I. INTRODUCTION

The wave of democratization in Latin America has been accompanied by a wave of neoliberal reforms, some successful and others not. The United States of America is vitally interested in the economic stability of Latin America. Once thought to be a breeding ground for communism, Latin America is now a regional partner seeking economic growth. The effects of economic instability in this region, once limited to Wall Street or Washington in the form of prices for produce or industrial jobs, can now be seen on the street corners of Seattle, Charleston, or even Bismarck, North Dakota. This is not an argument in favor of globalization, but a tangible and realistic view of how interrelated the Western Hemisphere has become. Visionaries of the past signed and passed NAFTA, paving the way for continued bi-lateral free trade agreements and ultimately a FTAA. After the ideological barriers against free-market economics lessen, the countries in Latin America become more receptive to necessary reform policies.

Market-oriented policies became extremely popular in the '80s, according to Dani Rodrik, a political economist for Columbia University, after two significant events.¹ First was the popularity, then failure, of import-substitutions policies, and second was the success of the 'Asian Tigers', whose market-oriented policies led to significant economic growth.² Once the light switch for probable economic growth was turned on, the next step has become overcoming political and domestic barriers. The examples of market success are easy to identify on the system level; however, real success occurs in the implementation and outcomes from economic reforms within the black box.

The purpose of this thesis is to analyze the actors, preferences, and institutions that give rise to democratically elected left-of-center executives who can also successfully carry out free-market reforms. In the past, political leaders in Latin America demonstrated a cultural and institutional propensity toward state-centric economic policies such as import controls, overvalued exchange rates, public ownership of major

¹ Market-oriented policies uses Adam Przeworski definition. Adam Przeworski, *Democracy and the Market: Political and Economic Reforms in Eastern Europe and Latin America*, (Cambridge:Cambridge University Press, 1991), 136.

² Dani, Rodrik, "Understanding Economic Policy Reform," *Journal of Economic Literature*, Vol. 24, (March 1996): 12.

enterprises, and price controls. Import substitution industrialization is the leading example of state-centric economic policies which sought to escape the dependence on unpredictable world markets through government-led industrialization³. Another example of a state-centric economic policy was Peru's 'heterodox program' instituted by the Garcia administration in 1985. The Garcia program tried to force an increase in real wages and consumption by freezing prices and interest rates, and by creating public works programs which were unsustainable, causing severe domestic current-account deficit and hyperinflation.⁴ State-centric economic policies were legitimized by prominent economists like Raul Prebisch, who argued for structural change to those countries on the periphery,⁵ and later by Fernando Henrique Cardoso in his *dependency theory*.⁶

It is not the purpose of this thesis to document the advantage of neoliberal economic policies over state-centric policies. Rather, it seeks to explain the continuing implementation of neoliberal economic policies by left-wing presidents, whose political campaign victories are achieved on diametrically opposite economic strategies. Some scholars focus on the pragmatic domestic political reasons for the change, while others emphasize the immense economic influence of the United States and sympathetic international institutions as the driving force behind widespread neoliberalism. This thesis will incorporate facets of both ideas by using an institutionalist approach.

A. MAJOR QUESTION AND ARGUMENT

1. Under What Conditions Do Democratically Elected Left-wing Governments Successfully Carry Out Free-Market Reforms?

³ Eliana Cardoso and Ann Helwege, "Import Substitution Industrialization," in *Modern Political Economy and Latin America: Theory and Policy*, ed. Jeffry Frieden, Manuel Pastor Jr., and Michael Tomz (Boulder: Westview, 2000) 155.

⁴ Dani Rodrik, "Understanding Economic Policy Reform," *Modern Political Economy and Latin America: Theory and Policy*, ed. Jeffry Frieden, Manuel Pastor Jr., and Michael Tomz (Boulder: Westview, 2000)

⁵ Ibid., 155

⁶ Fernando Henrique, Cardoso and Enzo Faletto. *Dependency and Development in Latin America*, translated by Marjory Mattingly Urquidi, Siglo Veintiuno editors, SA, 1971; reprint, Berkeley: University of California Press, 1979.

Historical evidence shows that democratically elected left-wing presidents will institute market reforms, under the influence of international and domestic actors. This influence supports dismantling barriers to reforms, dependent on the interests and preferences of the actors. While left-wing presidents do demonstrate agency in this process, institutions shape the process by which market-oriented reforms occur. Institutions are best defined by Peter Hall and Rosemary Taylor as “the formal or informal procedures, routines, norms and conventions embedded in the organizational structure of the polity or political economy.”⁷

B. METHODOLOGY

This paper will investigate how these elected heads of state implement free-market reforms and overcome obstacles created by domestic institutions, as well as examine the interaction between the executive and legislative branches of government and political parties. This paper will also examine international actors’ influence on domestic actors and institutions that facilitate neoliberal economic reform.

The ability for left-wing presidents to institute neoliberal reforms is most effectively explained by ‘rational institutionalism’ or ‘political economy.’⁸ This approach is deductive in nature, beginning with the policies and then analyzing the institutions that were created and used. These institutional frameworks created by the social aggregation of actors can be characterized as winning majority or power over any opposition procedures or routines. Procedures that are either under the table or merely informal norms of arrangements could be more efficient and cost too much to change. An important part of political economy is that actors are rational and the key to policy implementation is found in the details.

Rational actors seek to maximize their benefits with the least amount of cost, and as long as the benefits outweigh the cost policies are held in a favorable light. Barbara Geddes best sums up the approach of what people assume and thus how they make rational determinations: “first, choose the means they consider most likely to result in

⁷ Peter A. Hall and Rosemary C. R. Talyor, “Political Science and the Three New Institutionalisms,” *Political Studies* (1996), XLIV, 938

⁸ Hall, 945

desired ends; second, can weakly order their goals (that is, given any set of alternatives, they will prefer one or the other or be indifferent); third, hold consistent preferences.”⁹ Rational actors are not limited to individuals but also include organizations that are able to identify specific preferences. Both Geddes and Frieden refer to the rational-choice approach as “methodological individualism,” however, this author agrees with Frieden’s interpretation that self-interests alone do not explain social outcome. It is the logical analysis of basic entities (and their preferences) and their interaction which produce policies.¹⁰ The advantage of institutionalism or political economy methodology over strictly cost-benefit analysis is found in the details. Merely assigning numerical values or statistical interpretations of institutions overlook the human factor needed for success. Human factors ignored include informal procedures, interest aggregation, or historical analogies, to name a few. Just because the constitution of a country spells out procedure if benefits of informal channels exist, it is likely those avenues of least resistance will be the most effective.

Presidents, legislators, judges, political parties, and NGOs are actors whose interests and preferences are to maximize their utility. Actors will aggregate their preferences or seek a compromise when the possible outcome is in their favor or mutually detrimental. Aggregation and compromise are situational and could be seen as either a cost or benefit dependent upon the actor’s preferences. The most helpful example of interest aggregation could be found in a legislature that contains multiple political parties without one simple majority. In this scenario, political parties will aggregate and compromise to form a coalition that possesses a majority. This is seen in Chile in 1989 after political parties and national elections were authorized again, resulting in the majority of the left-wing parties from Christian-Democrats to Socialists collating their influence to win the presidency. The costs of cooperation were much less than the benefit of a presidential victory, but how does one place values on it? Cost-benefit analysis reduces the details and sacrifices of individual parties to utter simplicity. What

⁹ Barbara Geddes, “Uses and Limitations of Rational Choice,” *Latin America in Comparative Perspective: New Approaches to Methods and Analysis*, ed. Peter H. Smith, (Boulder: Westview Press, 1995, 83.

¹⁰ Jeffry Frieden, “The Method of Analysis: Modern Political Economy,” *Modern Political Economy Theory and Latin America: Theory and Policy*, ed. Jeffry Frieden, Manuel Pastor Jr., and Michael Tomz, (Boulder: Westview Press, 2000), 38.

was missed was the immediate creation of many institutions created by the *Concertacion* which are ever-evolving as special interests come to the forefront of polity.

This paper has a minor selection bias through its focus on the presidency as the source of weak opposition to trade liberalization. Presidents could suffer from historical analogies or cognitive inhibitions to change or maintain the status quo. Before World War I, Latin American markets were very open and liberal to Europe and the United States. However, very restrictive trade policies by the super-powers at war forced the developing world to seek their own market protection. The once-reliable imports were gone as well as the export market, forcing Latin America as a whole to create barriers of trade for revenue or governmental control over industrialization and successful export industries or commodities. This example could be a source of historical analogy for a president, which though unquantifiable by cost-benefit analysis is evident by the actions and arrangements made by an executive.

In Brazil President Fernando Henrique Cardoso is best known for diametrically political-economic positions. In his early years he wrote for local communist papers and generated a Marxist appreciation for politics common among scholars and students. His associations with leftists were not a secret and it forced him into exile 1964-1968, after a *coup d'etat*. While in exile, Cardoso wrote his most influential book, entitled *Dependency and Development in Latin America*, co-authored with Enzo Faletto, a young Chilean social scientist. This book coined the *dependency theory* emphasizing the dispersion of economic centers (first-world) and the periphery (third-world or developing countries) and how they depended on one another for status quo. This theory denounced trade liberalization as a country's social mobility, and in fact saw it as a source of restraint to keep the economically dominant center in control. These obvious and well-documented political positions make Brazil under Cardoso an obvious choice for a case study.

Political journals, works on international relations and political economy, periodicals, and government political services will serve as the sources of information. Secondary sources that include interviews are vital when investigating how actors group and coordinate along their preferences.

C. ASSUMPTIONS

Institutionalism is an excellent tool for demonstrating how market-oriented reforms are successfully turned into policy, but the main question in this paper is why a left-of-center president would want to employ such reforms. This can be viewed as a circle of action between the president, the lawmakers, the public and all other actors in between. The actors are linked by institutions, thereby giving each actor two options of policy: to be the action originator (instigator) or the reactor. A president will either move forward with his/her policy agenda within the institutions or become part of the institutional process instigated by another's preferences.

Dani Rodrik writes of two pillars upon which the new orthodoxy is founded: first the example of the Asian tigers, and second the tried and failed policy of Import Substitution Industrialization (ISI).¹¹ Rudiger Dornbusch argues that the flood of liberalization stems from four factors: failed state-centric policies, poor economic performance, exposure to globalization and the increase in information, and World Bank pressure and evidence of success.¹² Trade liberalization or free-market reforms appear to be very pragmatic in origin, ignoring the significance of left-wing executive influence. However, pragmatic causes for market-oriented reforms embody the essence of what this paper is trying to demonstrate; that neoliberalism can exist under a left-of-center president. This is the basis for the first assumption of this paper; that market liberalization is beneficial to a country encouraging economic growth.

It is difficult to systematically identify and single out a specific trade policy that leads to growth; however, John Williamson had compiled a useful list of policies known as the 'Washington Consensus' delineating free-market reforms. The case studies will use Williamson's ten areas of policy reform as the criteria for successful market-oriented

¹¹ Rodrik, "Understanding Economic Policy Reform," *Journal of Economic Literature*, 13

¹² Rudiger Dornbusch, "The Case for Trade Liberalization in Developing Countries," *Journal of Economic Perspectives*, Vol. 6, No. 1, (Winter 1992), 69-70.

reforms: (1) fiscal discipline, (2) public expenditure priorities, (3) tax reform, (4) financial liberalization, (5) exchange rates, (6) trade liberalization, (7) foreign direct investment, (8) privatization, (9) deregulation, (10) property rights.¹³ The consensus is well known for its checklist-style determination of first-generation neoliberal economic reforms. This thesis is not trying to make a caricature of the Washington Consensus, but use its insight and simplicity as guidelines for examining the following case studies.

D. CHAPTER SUMMARIES

1. Importance

The first chapter of this paper is a thorough examination of the importance of analyzing left-of-center presidents who are rhetorically against liberalizing markets, but recent historical evidence proves otherwise in certain situations. The United States is vitally interested in the democratic and economic success of developing countries, as stated in United States National Security Strategy, Sections VI and VII. Latin America is generally portrayed as a continent of developing countries; coupled with its proximity to the United States, Latin American economic success is of national interest for the sake of democracy, regional stability, and security.

The President of the United States' National Security Strategy highlights the importance in economic growth of developing countries and expanding free trade throughout the world published in sections VI and VII. Section VI is titled "Ignite a New Era of Global Economy Through Free-markets and Free Trade", and Section VII is "Expand the Circle of Development by Opening Societies and Building the Infrastructure of Democracy." This paper examines a possible unstable environment in Latin America for democracy and liberal markets as a result of political swings to the left in recent presidential elections in Latin America, which raise the concerns of U. S. investors and policy-makers over regional stability. However, a better understanding in the occurrence of market reforms by left-of-center presidents will prove to be very beneficial to U.S. policy makers. Once fully developed, these hypotheses could prove to be a useful tool

¹³ John Williamson, *the Progress of Policy Reform in Latin America*, (Institute for International Economics: Washington, D.C., 1990), 9-31.

for multinational corporations, non-governmental organizations, and any other actors whose economic investments are affected by the politics of heads of states.

2. Chilean Case Study

President Aylwin successfully implemented free-market reforms even though they were not his preferences. However, the ability for Chile to retain the previous regime's reforms is just as important as forwarding the reform process. Aylwin's economic preferences were distracted by the transition back to democracy, Pinochet remaining as Commander of the Army, and the political strength of right-wing congressmen pacifying any success in constitutional or legislative reforms. This distraction was also evident to the international actors who showed minimal concerns with the direction of the Chilean markets; however, the distraction led to maintaining the newly formed status quo.

The economic liberal policies were credited to Pinochet and his technocrats, the "Chicago Boys," overcast the success of President Aylwin's administration. President Aylwin defeated a powerful self-appointed president under a weak and loosely developed political ticket. As president his administrations choose to operate under the established institutional framework, and make changes within the same context. This framework limited his autonomy, highlighted by the Interministrial Committee on the Economy insulation, led by the finance minister Foxely, which administered the executive branch of the government public policy. These institutions generated new frameworks, and Aylwin choices facilitated continued economic reform both directly and indirectly.

3. Brazilian Case Study

Brazil under Fernando Henrique Cardoso successfully implemented first-generation neoliberal reforms, as outlined in the 'Washington Consensus.' This chapter summarizes the critical issues that faced Cardoso during his second term in office, issues historical and contemporary.

The Brazil chapter will highlight Cardoso's past and a lethargic legislature as opposition to economic reform. However, *Real Plan* and opening state monopolies on petroleum, telecommunications, electricity, and natural gas are examples of Cardoso

successfully implementing reforms. However, Cardoso also failed to implement some reforms. Inequality, hyperinflation, monetary policies for generating growth, lack of proportional education funding, and the inefficient enigma of a social security system are the critical issues that not only plagued Cardoso, but continued into Lula's presidency.

A unique difference between the Brazil case study and Chile is the role of the president as an instigator or inhibitor to reform, hence, the need to consider both environments and avoid the 'black box' labeling. In identifying the institutions within the black box the paper can unravel some secrets to neoliberalism success, regardless of presidency, thereby possibly easing anxiety of future democratically elected socialist presidents.

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II. CHAPTER TWO: US NATIONAL SECURITY AND ECONOMIC REFORM IN LATIN AMERICA

As Richmond M. Lloyd states, “national interests are the ‘wellspring’ in which national objectives and grand strategy flow.”¹⁴ The National Security Strategy under the George W. Bush administration is pillared upon economic prosperity and liberty of the developed world, defense of the homeland, and promotion of democratic values. Since the Goldwater-Nichols Act of 1986, every administration is required to generate a schedule of security interests that are nationally important, or national strategic objectives that address U.S. threats.

Economic growth and prosperity is not a new strategic objective. Arguably it could be traced back to Wilsonian ideology of spreading democracy for the benefit of those without it, or maybe further. However, the historical sequence of spreading economic prosperity to the globe is not on trial; under deliberation is its continued importance on a national level in light of recent events. The loss of the World Trade Center, the War on Terrorism, war in Iraq, and furthering a policy of preemptive military intervention are high political items, but what elevates the economic growth of developing countries into high politics? Condoleezza Rice writes that the National Security Strategy is founded on three pillars, the last of which is to “extend peace by extending prosperity and freedom throughout the globe.”¹⁵ This chapter ties together regional economic policy and U.S. strategic objectives.

This chapter intends to demonstrate its importance and the relevance of studying neoliberal reforms in a national security affairs curriculum by dissecting the most current National Security Strategy and its applicability to Latin America. Specifically the NSS emphasizes free trade and improving the developing world in two chapters: Section VI is titled “Ignite a New Era of Global Economy through Free-markets and Free Trade;” and Section VII is “Expand the Circle of Development by Opening Societies and Building the

¹⁴ Richmond M. Lloyd, “Strategy and Force Planning Framework,” *Strategy and Force Planning* Faculty, eds., *Strategy and Force Planning*, 3rd ed. (Newport, Rhode Island: Navy War College, 2000) 5.

¹⁵ Condoleezza Rice, “The Balance of Power that Favors Freedom” *U.S. Foreign Policy Agenda*, an electronic journal of the U.S. Department of State, Vol 7, Number 4, 5

Infrastructure of Democracy.” The argument is that economic growth of developing countries through free trade agreements strengthens states, preventing weak or failed states. Strong and stable states, in turn, minimize civil unrest and encourage foreign support and the opinion of all things American.

Washington believes that left-of-center presidents compromise U.S. security strategy. This thesis demonstrates otherwise, using Chile and Brazil as empirical examples. What is the grand Washington design for economic growth in the developing world? It is free trade and free-markets. This paper establishes the philosophy and pragmatic reasons for which U.S. national security strategy supports developing countries’ prosperity.

A. WHY THE U.S. SUPPORTS LATIN AMERICAN DEVELOPMENT

Why is Latin America’s economic prosperity important to the U.S. National Security Strategy? Developing countries which do not have the infrastructure or institutions to manage internal security or monitor imports of terror are possible breeding grounds for terrorists, insurgents, or revolutionaries. Without sustained development, developing countries could easily become unstable, undemocratic, or turn into a failed state, all of which are detrimental to U.S. interests, citizens, and territory.

Economic growth encourages compromise, political stability, and democracy, and inhibits popular support for terrorist organizations. The United States National Security Strategy prescribes supporting international peace by extending the benefits of prosperity and liberty. The answer sounds too simple: that through the spread of democracy, personal liberties, and open-markets, prosperity will ensue and international peace will be supported. A “paradigm of progress” has emerged among the developed and developing countries of the world that share a commitment to democracy, the rule of law, a market-based economy, and open trade.¹⁶

¹⁶ Condoleezza Rice, “The Balance of Power that Favors Freedom” *U.S. Foreign Policy Agenda*, an electronic journal of the U.S. Department of State, Vol 7, Number 4, 7

B. ANALYZING THE NATIONAL SECURITY STRATEGY FROM AN ECONOMIC PERSPECTIVE

Seize the global initiative. This is a declaration of proactive U.S. nature, seeking trade agreements and actively using institutions and organizations like the WTO and IMF to further U.S.-led world growth. This endeavor does not amend U.S. policies or attention toward Latin America

Press regional initiatives. NAFTA has been a success and has withstood the border-tightening since 9/11. The NSS designates 2005 as the goal date for establishing a Free Trade Agreement of the Americas. This objective is not candidly offered, because of the historical precedent set by NAFTA, which was once thought to be unmanageable, yet prevailed. “A strong world economy enhances our national security by advancing prosperity and freedom in the rest of the world.”¹⁷ Free trade on a global level must begin with regional blocks, and these coalitions with interdependent markets will lead to continued interdependence beyond trade into such important issues as security.

Move ahead with bilateral free trade agreements. The U.S. has specifically targeted Chile as its next bi-lateral free trade partner, but also set its sights on countries in Central America. It is believed that with more bi-lateral trade agreements the goal of creating FTAA becomes more fathomable.

Renew the executive-congressional partnership. This was a common problem in the U.S. administration, which would hold up trade promotions by requiring a consensus in congress as well as Presidential go-ahead. This has supposedly been streamlined to negotiations with developing countries by the Trade Act of 2002, which lack time, infrastructure, and depth of resources to wait on U.S. bureaucracy.

Promote the connection between trade and development. This objective tries to encourage established institutions like the WTO to remain flexible for poorer countries. The Caribbean basin is a target of this initiative, tying public health and the most basic needs conditional to trade pacts. However, these conditionalities would be subsidized by the U.S. The precedent for this is set by the Africa Growth and Opportunity Act.

¹⁷ The National Security Strategy, September 2002, <http://www.whitehouse.gov/nsc/nss.pdf>, 21.

Enforce trade agreements and laws against unfair practices. Enforcement is an ideal easily corrupted by powerful lobby groups. Still, it is a commitment and the U.S. addresses these claims of trade impropriety to recognized institutions like the WTO. NAFTA has an internal judiciary body to handle agreement clarifications or violations. It is necessary for all participants in a free trade coalition to bind themselves to the virtue of enforcing trade agreements and laws, which does not negate confusion or mistakes, but it does coerce all parties to communicate and agree to a mediating or arbitrating forum.

Help domestic industries and workers adjust. This statute is most evident in the steel industry, where safeguards are in place so that ‘benefits to free trade do not come at the expense of American worker.’ This is an area of great contention, especially after the previous declaration of intolerance toward unfair practices. The “expense of American workers,” can easily be an excuse used by a Latin American country. This irony or hypocrisy will be addressed later.

Protect the environment and workers. This article generates potential barriers to free trade, as was witnessed during the NAFTA negotiations. The country with higher emission and labor standards tend to lose comparative advantage, but this article tries to level the playing field.

Enhance energy security. Alan Larson, the Undersecretary of State for Economic, Business and Agricultural Affairs, is most concerned with the expanding reliable sources of energy, transport security, and terrorism finances in easing the impact of economic shock. Latin America is best poised to provide for U.S. demand of a reliable steady supply of energy without benefiting any terrorist organization. This is sought by spreading the oil resources away from strictly Middle Eastern origins. Latin America plays a strategic role in stabilizing the global market by providing a higher percentage of energy resources. The percentage of oil the U.S. received from Venezuela and Mexico has increased over the last few years and is in keeping with the NSS to stabilize against economic shocks

Alan P. Larson gives a good summary of the comprehensive strategy.

“Economic strength and resiliency are the foundation of our national security. The economic dimension of the National Security Strategy focuses on three priorities: First, we must assure economic

security by making the U.S. and global economies more resilient to economic shocks. Second, we must advance a global prosperity agenda by expanding trade and investment between nations. Third, we need to ensure poor nations participate fully in the rising tide of prosperity.”¹⁸

Not once in the comprehensive strategy for free trade was security mentioned except for energy. How does this relate to external threats, terrorism, narcotics trafficking, or weapons of mass destruction? This is the foundation of Article VI of the National Security Strategy, which begs the question, where does it apply or relate to security? The U.S. cannot address the threats of terrorism without a global coalition which is strengthened by the prosperity and growth of developing countries.¹⁹ Focusing on Latin America, the rest of this paper will address the potential security benefits that are associated with free trade alliances, as well possible downsides.

C. LATIN AMERICAN REALITIES

U.S.-Latin American relations have not always been grounded on good intentions. However, contemporary perceptions toward U.S. security have created a paradigm shift that recognizes the importance of economic prosperity paralleling and bolstering U.S. national interests. This elevates economic growth into “high politics” and Latin America is strategically poised to symbiotically gain from U.S. strategic policies. “As economic policy and market relations further push traditional strategic policy off center stage and modify diplomatic affairs, will regional security be weakened or strengthen?”²⁰

Starting with President George Bush in 1990 in announcing the Enterprise for the Americas Initiative, economic and democratic stability throughout Latin America became the *modus operandi* for U.S.-Latin American relations during the 1990s. The end of the Cold War and an end to U.S. fears about Soviet intentions in the region facilitated this evolution.

¹⁸ Alan, P Larson. “Economic Priorities of the National Security Strategy” *U.S. Foreign Policy Agenda*, vol. 7, no. 4: 19

¹⁹ Larson, 21.

²⁰ Georges A. Fauriol foreword to Patrice M. Franko, *Toward a New Security Architecture in the Americas: the Strategic Implications of FTAA* (Washington D.C.: The CSIS Press, 2000), X.

This trend to regionalize free trade and create market coalitions in Latin America was partially led by U.S. initiatives, and has found support in Latin America. NAFTA preceded MERCOSUR, which was followed by the Caribbean Free Trade Area. Currently, the U.S. is continuing toward bi-lateral free trade agreements as well as a hemispheric Free Trade Agreement of the Americas. Integrating the Western Hemisphere into a free-market coalition will encourage each country to collectively address issues that cross borders, such as international security threats, proliferation, terrorism, immigration and environmental protection, to become regional or hemispheric issues. Strengthening the economic ties of regional trading blocs will strengthen multilateral issues. Where once security issues were dealt with across borders and tended to be the other countries' responsibility, Countries will now be forced to take ownership of internal security issues to maintain the status quo created by the coalition.

Patrice Franko, a political economist at Colby College in Waterville, Maine believes, "Improvements in economic relations in the hemisphere were clearly seen as an opener to broader partnerships throughout the region to tackle tough transnational issues such as terrorism and counter-narcotics."²¹ The terrorists who flew the airliners into the World Trade Center, Pentagon, and that Pennsylvania field were not poor and did not live in squalor, "but when nations fail to meet the most basic needs of their people these failed states become havens for terror."²² It is difficult not to draw a tangent from this subject, but this paper's focus is on highlighting the U.S. security benefit from the economic growth of developing countries. Free trade agreements between developed and developing countries require the developed country to carry the brunt of the administrative and infrastructure burdens of the agreement, while the latter makes economic, cultural, and environmental sacrifices that often inhibit comparative advantages. This cooperation translates to a different level of trade, one beyond the plan of industry and commodities, to human and cultural capital transactions.

Ensure poor nations participate fully in the rising tide of prosperity. Larson concisely states that, "Capital is a coward. It flees from corruption, bad policies, conflict,

²¹ Patrice M. Franko, *Toward a New Security Architecture in the Americas: the Strategic Implications of the FTAA*. (Washington D.C.: the Center for Strategic and International Studies, 2000), 11

²² Larson, 21. Quoted from President Bush's address in Monterrey, MX March 2002.

and unpredictability.”²³ “All governments are responsible for creating their own economic policies and responding to their own economic challenges. We will use our economic engagement with other countries to underscore the benefits of policies that generate higher productivity and sustained economic growth.”²⁴The NSS states that a “long-term objective is a world in which all countries have investment-grade credit ratings.”²⁵

It has been established that generating a regional free trade agreement forces countries to not only internalize externalities, but agree to a measure of standard on transnational issues. Besides the goal of FTAA by 2005 and the NSS proclaiming global economy as critical to national security, what other policies have parallel objectives of improving economic growth and security? Are there any downsides to these ideals?

D. POLICY PRESCRIPTIONS

The National Security Strategy advocates pro-growth fiscal policies, lowering marginal tax rates, rule of law and intolerance of corruption, strong financial institutions, and sound fiscal policies, investments in health and education, and free trade. “Patient perseverance and respect for national sovereignty by the United States are the keys to promoting permanent and sustainable security architecture in the region.”²⁶ The ironic side to “patient perseverance” is these expectations require countries throughout the region to do more with less. It would take more government to address the problems of meeting the new coalition requirements as well as managing the economic gains.

This chapter captures the perspective of the NSS take towards growth of developing countries; however, there are holes, or rather hypocritical goals, from the ambivalent super power. The NSS emphasizes the importance of strengthening the

²³ Larson, 21.

²⁴ NSS, 17.

²⁵ NSS, 18.

²⁶ Franko, XVI

economies of our allies in Europe and Japan as well as preserving economic growth in the developing world.

The comprehensive free trade strategy to protect American workers is perceived as contrary to extending economic growth to developing countries. Protecting U.S. specific industries is vital to U.S. interests and national security, but expanding a global economy through free trade is part of the National Security Strategy. This confusing arrangement can be summed up through an institutional analysis, examining why certain special interests have more power and influence on policy outcome. This dilemma is relevant in relations with Brazil and other countries who look to the United States for fair and equal market opportunities, while at the same time being expected to make sacrifices.

E. ANALYSIS

There is a congressional requirement for a National Security Strategy to highlight and outline the physical strategic threats and/or objectives. This chapter answered the question why expanding the global market is important to such strategy and national interests. When focusing on Latin America Patrice Franko says it best: “a wider array of strategic goals without a clear external orienting principle presents new opportunities and new challenges for U.S. relations with the hemisphere.”²⁷ Amidst confusion, the National Security Strategy benefits from a “comprehensive strategy to promote free trade” toward Latin America. Regional coalitions that expand U.S. markets also build extensive security arrangements.

“Today’s threats come less from massing armies than from small, shadowy bands of terrorists — less from strong states than from weak or failed states. And after 9/11, there is no longer any doubt that today America faces an existential threat to our security”²⁸

This clearly expresses the legitimacy of trade agreements and economic growth and stability in Latin America as key to U.S. strategic concerns; however, the goal of FTAA by 2005 is not a means to an end. The developing countries continue to embrace

²⁷ Franko, 2

²⁸ Condoleezza Rice, “The Balance of Power that Favors Freedom” *U.S. Foreign Policy Agenda*, an electronic journal of the U.S. Department of State, Vol 7, Number 4, (2002), 5

U.S.-led free trade agreements, whether bi-lateral, multi-lateral, or hemispheric coinciding with the National Security Strategy prescription. There are costs associated with such agreements, but they do not outweigh the benefits gained from economic growth, multinational interdependence, and most importantly global security in this environment of terror and borderless criminals.

The National Security Strategy is pillared by the importance of economic policies with regards to developing countries that are pragmatic, multilateral, and expand the global marketplace. Left-wing presidents who campaign on social programs and fiscal policies counter to neoliberalism, are perceived as a threat to U.S. national interests. This thesis is written to provide solace to Washington, that each situation must have its details fully investigated. Institutions that exist and new ones created have more impact on the policies of a left-wing president recently elected. The same notion is less valid in a dictatorship or totalitarian regime, but in a democracy institutions make policy.

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III. CHILEAN CASE STUDY

Under what conditions do democratically elected left-wing parties successfully carry out free-market reforms? This chapter will examine the institutions that permit or force democratically elected left-of-center executives to successfully carry out free-market reforms. Institutional considerations include international actors' influence on domestic actors and their institutions that facilitate neoliberal economic reform, and how these elected heads of state implement free-market reforms, overcome obstacles created by domestic institutions, and the interact between the executive and legislative branches of government and political parties. Institutional framework, actors and their preferences, and its interaction will first be generalized for an eventual study of Chile.

Left-of-center parties are rhetorically against liberalizing markets, when in fact historical evidence proves otherwise in certain situations. This chapter examines Chile under President Patricio Aylwin, 1989-1994, who a politically left-of-center leader who successfully implemented free-market reforms. The case of Chile will support the hypothesis that left-of-center presidents can implement free-market reforms.²⁹ The International Monetary Fund is sometimes viewed as the cause for economic reforms, but there is an avenue of reason where presidents will act on their own preferences, autonomous of international influence.³⁰ Left-of-center presidents will act on their preferences either autonomously or compromise with actors whose preferences are similar, resulting in an aggregated coalition with which to interact in the boundaries of an institutional framework.

Utilizing the political economy methodology, actors and their preferences encompass international actors, heads of state, sub-national actors, and organizations or institutions that possess a unified preference which may have influence upon other actors. The next step for this analysis is to identify how these actors group themselves through

²⁹ Przeworski, *Democracy and the Market*, 138-140 emphasizes transitional costs.

³⁰ Barbara Geddes, "Building 'State' Autonomy in Brazil, 1930-1964," *Comparative Politics*, Vol. 22, (January, 1990), 217.

cost-benefit compromises based on their preferences.³¹ This methodology is deductive in nature. Policy outcomes are the end results whether you start with an examination of actors or institutional framework.

Before delving into the case study, this chapter will identify some institutional nuances that, until now, were only briefly addressed. Common understandings or institutional designs between democracies will be examined to provide influential frameworks for the outcome of policies.

A. ACTORS AND THEIR PREFERENCES

1. Heads of State

Executive branches of government who have been elected by their people representing a political affiliation that is politically left-of-center theoretically could be moderate in their economic preferences merely to get elected, or are pragmatic in concern about economic policies and growth which results from policies represented by the “Washington Consensus.” However, these pragmatic free-market reforms are in most cases difficult to swallow. What causes a left-of-center president to abandon their political lines? This question is first answered by two categories. The first category contains reforms exercised by the president autonomously for the good of the country and the people. This pragmatic approach originates from the president’s preference to seek neoliberal economic policies. Presidents could segregate themselves by retaining the label “left-wing” but contain instincts to implement neoliberal reforms, or have occurred because the state possessed enough autonomy to reform in tandem with or against the preferences of other actors. A strong external influence could hold sway over a president’s preferences resulting from interpersonal relationships; like an older brother or the wiser “outside-looking-in” advisor role. However the distinction is that economic liberalization is championed by the president.

The second reason for a left-of-center president to support free-market reforms results from reaction to institutional factors. A president would compromise economic

³¹ Jeffry Frieden, “The Method of Analysis: Modern Political Economy,” *Modern Political Economy Theory and Latin America Policy*, Edited by Jeffry Frieden, Manuel Pastor Jr., Michael Tomz. Westview Press: Boulder, Colorado. 2000. 37-43

policies for other agenda items, or be a victim of a more powerful actor's preferences. This category emphasizes power as a possession in existing institutions. Power within institutions could be focused on actors or a group of actors who aggregated their influence to achieve a mutual objective. Second category reforms are due directly to the lack of presidential power or influence on economic policies, or result from low presidential priority. This dilemma is the key to the socio-economic explanation of economic policies contradicting preferences. The work is in digging for the details.

2. International Actors

International actors' preferences differ as much as their identities do. International actors encompass multinational corporations, nongovernmental organizations, and heads of states with their diplomats. The preferences of multinational corporations are predominantly financial; furthermore, along that line of preferences in regards to economic reforms, MNC's would choose either for or against based on three criteria: 1) Will reform bring profits? 2) Will the benefits of this reform outweigh the costs? 3) Do these reforms pay back the lent money with interest, or at least continue providing a return or investment? The latter of the three preferences is arguably the most important to the corporations featured in this paper because economic reforms are not varied. Holding the dependent variable constant, neoliberal economic reforms create a preference bias derived from the corporations, so much that these reforms concentrate on fiscal discipline as well as freeing markets and resources to the corporations' advantage.

International governmental organizations' (IGOs) interests in economic reforms are focused on social implications such as economic growth, worker's rights, poverty reduction, income equality, infrastructure development, institutional development, or fiscal discipline, to name a few. IGOs with the greatest impact on economic reforms in Latin America include such institutions as the International Monetary Fund (IMF), World Bank, Inter-American Development Bank, and the Catholic Church. The international social NGOs like the Church and AFL-CIO have preferences toward economic reforms partial to a specific social agenda, human rights, equality, worker's rights, and party

organization, which are fundamentally distinguishable on the domestic or state level of analysis by more financially motivated NGOs.

IGOs like the World Bank and other development banks have a vested interest in economic reforms beyond social applications. Development banks are organized to lend money to countries for infrastructure projects like roads, dams, or bridges. However, these banks must be reimbursed the money lent, including interest, in order to continue this service to other nations. Neoliberal economic reforms are favored by development banks because they highlight reducing and increasing revenue in order to pay the bills. The banknotes are a priority expense, thus aligning their preferences toward reforms of this nature; to get back to the point, what is their role in influencing countries and their presidents to institute neoliberal reforms.

The IGO who has the most influence on Latin American economic policies is the IMF. The IMF provides short-term funds to countries struggling through an economic downturn or suffering the woes of economic reforms. However, there are two powerful consequences that come with seeking the IMF for assistance. First and foremost is the conditionality of loans. The IMF will not loan funds unless free-market reforms are instituted, in fact the loans are phased in as a country meets predetermined criteria of reforms. In essence the IMF preferences will almost always be toward neoliberal reforms, because the availability of IMF funds is conditioned around such reforms. The second consequence is that before any development bank will invest in a country, an up-check from the IMF must first be obtained. This adds to IMF's legitimacy and the power it wields over developing countries.

The IMF wields power over developing countries with its approval certification for development banks and its access to funds designed to shore up democratic governments' economies to prevent collapse or bankruptcy. The conditions required by the IMF are in the interests of the fund itself and for investors from other NGOs or MNC's because of the fundamental reform required for these countries to have greater revenue expenses: maintaining the repayment of loans and investments and their interest as a mandatory expense. This tends to rally international actors behind the IMF and their preferences; on the other hand this does not usurp the autonomy of the president, but

leads us to further our investigation into how these actors group and then come to an agreement based on the institutional frameworks to navigate.

B. INSTITUTIONAL FRAMEWORK

Institutional framework is arranged by tangible and intangible institutions. Tangible institutions include buildings, organizations, constitutions, laws, and administrative rules. Intangible institutions focus on the interpersonal networks, the charisma of a leader, or loopholes in a tangible institution. Intangibles can be culturally derived from customs and ceremonies. The web of actors interacting through these institutions constitutes the framework. As a reminder, “institutions are the formal or informal procedures, routines, norms and conventions embedded in the organizational structure of the polity or political economy.”³²

Jeffrey Frieden best explains the importance of institutional framework in trying to explain reforms: “to explain how the constraints set by existing institutions affect the political activities of socioeconomic interests...illuminating the process by which social actors work through markets, parties, bureaucracies, and political systems to obtain their goals.”³³

C. POLICY OUTCOMES

Preferences toward free-market reforms held by a president are greatly dependent upon the individual, which vary between hard line supports to hard line opposition. Once again, due to the scope of the case study selection holding the dependent variable constant, the preferences of left-of-center presidents chosen will vary but generally fall in the middle of opposition hard liners. The occurrence of free-market reforms can not spell out the preferences of the presidents; altogether the left-of-center presidents would prefer national control of markets, resources, and policies.

³² Peter A. Hall and Rosemary C. R. Talyor, “Political Science and the Three New Institutionalisms,” *Political Studies* (1996), XLIV, 938

³³ Frieden, 42.

As mentioned earlier, international actors influence left-of-center presidents, especially in the developing countries of Latin America. The presidents pursue their interests for state economy while confronting intervention by institutional designs for insulation or actors' persuasion. The policy outcome (free-market reform) will not resemble the initially desired end state unless the state can afford the autonomy. Therefore, the policy outcomes are a result of established institutions and new institutions created by actors with the most power and influences. The preferences of individual presidents will be more closely defined within individual case studies, but the bottom line is that the answers are in the details. Black box theories cannot explain the policy outcomes of domestic polity. The actor preferences, their influence, their grouping of interest, and the institutions they establish or conduct their efforts through determine policy outcome.

D. CHILEAN ACTORS, THEIR PREFERENCES, AND HOW THEY GROUP

President Patricio Aylwin was the first elected president in Chile after the military dictatorship under General Pinochet. President Aylwin was nominated on the *Concertacion* ticket, formed from the unification of the Socialist and Christian Democrat Party in opposition to the right-wing conservatives and military regime. Aylwin interests were closely aligned with the Christian Democrats' left-of-center preferences, including government intervention to ease social inequality, nationalization of industries, and state management of monetary policy. Remnants of Pinochet's economic programs were unregulated big business. Pinochet is credited for precedent-setting economic liberalization. While his administration may have started the momentum, it was the Aylwin administration's egalitarian perspective that consolidated and furthered reform.

However, President Aylwin did not possess complete control over the state's policy. The executive branch's preferences were split in two. On one side, there were goals to increase taxes for social programs, while the other contended on continuing liberalization.³⁴ Aylwin's preferences leaned toward social programs which ran counter to the preferences of Finance Minister Alejandro Foxley who had a decisive role in public

³⁴ John Sheahan, "Effects of Liberalization Programs on Poverty and Inequality: Chile, Mexico, and Peru," *Latin American Research Review*, Vol. 32, Iss. 3 (1997), 18.

policy development³⁵ The finance ministry in the beginning was a unified, cohesive, and integrated institution, virtually autonomous from political oversight.³⁶ Foxley closely collaborated with Carlos Ominami, minister of the economy, further strengthening his role in determining policy.³⁷

To summarize Chile's governmental preferences, Aylwin interests were social programs, but his minister of finance wanted to further free-market reforms. These competing agendas were individually thought to be in the best interest of Chile. The perfect example was the dilemma between government, private business, and labor left by Pinochet. Under Pinochet, taxes on business profits were lower than the regional average, and employers had gained almost complete control over workplaces.³⁸ In the midst of this issue, Patricio Aylwin's priority was to find a compromise that would strengthen Chilean democracy. The business-labor-tax issue demonstrates the importance of institutions in making policy. Taxes on profits were raised from 10 to 15 percent to fund social programs, but remained well below the majority of Latin American countries; while labor conditions minimally improved with a slightly higher minimum wage and some restraint on a firm's right to fire.³⁹

The multiple political parties from the democracy prior to Pinochet retained their identities, but aggregated their policy positions and power into two dominant political coalitions. The *Concertacion* is made up of the Socialist Party of Chile, Christian Democratic Party, and Party for Democracy, Social Democratic Radical Party, Social Democratic Party, and Center Alliance Party. The conservative party is known as the Alliance for Chile and is composed of the conservative right wing, including National Renovation, Independent Democratic Union, and Progressive Center-Center Union.

Some scholars believe unifying into two coalitions as superficial, a result of elaborate political pacts; “pacts that intensify inter-party conflicts rather than promote

³⁵ Judith Teichman, *The politics of Freeing Markets in Latin America: Chile, Argentina, and Mexico*, Chapel Hill: The University of North Carolina Press, 2001), 84.

³⁶ Teichman, 84

³⁷ Teichman, 88

³⁸ Sheahan, “Effects of Liberalization Programs on Poverty and Inequality: Chile, Mexico, and Peru,” 18

³⁹ Sheahan, 19

party unity.”⁴⁰ The effects of two political coalitions competing for majority in the parliament will aggregate, organize, and gravitate ideals toward the moderate middle to accommodate party members. Given this bi-polar political environment, preferences can be clearly assigned to either left- or right-of-center along the political spectrum. Right-wing conservative preferences distinguish the importance of decentralizing state influence in the economy from policy making to industrial management. Chilean right-wing ideals economic ideology aligned closely with the “Washington Consensus”. During this time of democratization, the military aligned themselves squarely behind the Alliance party and continued loyal support of General Pinochet, Commander of the Army, who had not completely distanced himself from politics. On the opposite end of the political spectrum, left-wing preferences rely on the civil and fair hand of the state to manage, govern, and implement economic strategies to promote justice and equality. Left-of-center interests argue against neoliberal reforms; supporting price controls and market insulation for the purpose of affordable products grown and manufactured by and for Chileans.

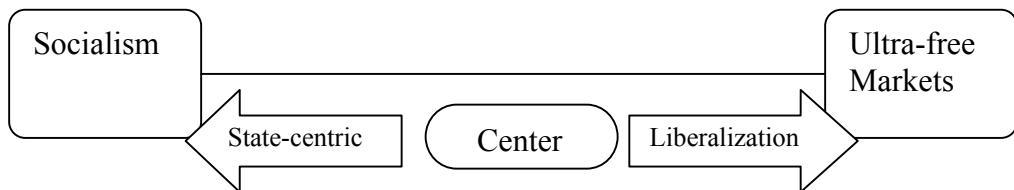


Figure 1. Economic Policy Continuum

E. INTERNATIONAL ACTORS AND PREFERENCES

“Foreign actors may affect the development of internal political and economic conditions either by specific actions or by omission.”⁴¹ International actors’ preferences

⁴⁰ Peter Siavelis and Arturo Valenzuela, “Electoral Engineering and Democratic Stability: The Legacy of Authoritarian Rule in Chile,” *Institutional Design in New Democracies: Eastern Europe and Latin America*, edited by Arend Lijpart and Carlos H. Waisman. (Boulder, Colorado: Westview Press, 1996) 78.

⁴¹ Alicia Frohmann, “Chile: External Actors and the Transition to Democracy,” *Beyond Sovereignty: Collectively Defending Democracy in the Americas*, Edited by Tom Farer, (John Hopkins University Press, 1996), 248.

in Chile focused on social support and recovery from the transgressions recently experienced under Pinochet. The majority of external actors' input in Chile during Aylwin's administration focused on human rights violations; funding for local NGOs, social movements, and political parties.⁴² The IMF and World Bank were in favor of free-market policies, which the United States supported to the extent of seeking a U.S. bilateral trade agreement. However, there existed under Aylwin's presidency resistance to Pinochet's "Chicago Team," which was not without international influence. "The World Bank's close working relationship with the military regime was deeply resented by the Concertacion officials, and officials of the bank reluctantly came to accept that this situation constrained their influence."⁴³

The Chileans were relatively successful at implementing neoliberal economic reforms under the Pinochet administration, which constrained the following *Concertacion* government. This success has led many developing nations to conclude that autonomous leaders are required to institute reform, to be more successful after a crisis. Jose Pinera was Minister of Labor and Social Security under Pinochet, and he attributes their success to four points: a unified coalition, the element of surprise, the media or will of the people, and a leader.⁴⁴ These four points are not given equal weight; in fact, the most influential dynamic of their success was the coalition of economists. Pinera interviewed one of the generals under Pinochet as to why, of all the policy advice available to the generals from businessmen, industry leaders, and lawyers, they chose to listen to them. The General answered, 'Because you agreed with each other and gave us simple answers to our questions.'⁴⁵ The fact is the Chilean team of economists were similarly trained and educated by western, 'Anglo-Saxon' economics at the University of Chicago.⁴⁶ The University of Chicago's influence on economic policy became so interwoven in the Chilean economic fabric that, "by the mid-1970's a core group of some 50-100 of Chile's best economists were thoroughly conversant with and convinced of the need to adopt a

⁴² Frohmann, 249.

⁴³ Teichman, 88

⁴⁴ Jose Pinera, "Chile," in *the Political Economy of Policy Reform*, ed. John Williamson (Washington D.C.: Institute of International Economics, 1994) 225-231.

⁴⁵ Pinera, 226

⁴⁶ Pinera, 226-227

free-market approach to economic policy.”⁴⁷In an effort not to belabor this digression, the economic success of Pinochet was due to a coalition of like-minded economists, central to the theme of this thesis that institutions are significant in successful reforms.

External actors during the Aylwin administration concentrated their attention on sustaining the transition to democracy and maintaining neoliberal reforms. The first task was to supervise, facilitate, monitor, and motivate the transition to be bloodless and establish a sound foundation for consolidation. On the other hand, the previous success of the military regime in instituting free-market reforms meant that the influence of IGOs in economic policy was less critical once it became clear that President Aylwin inauguration and his ministers continued neoliberal policies.

F. INSTITUTIONAL FRAMEWORK

Chile’s transition to democracy from authoritarian rule was controlled, methodical and bloodless, which facilitated leaders in opposition to the military and conservatives to organize and consolidate their political agenda. Institutional frameworks played a very significant role in the transition of Chilean democracy, providing a window of opportunity for the Aylwin administration to build a consensus around economic policy.⁴⁸ Lingering institutions after Pinochet stepped down were both good and bad. Remnants left behind included decentralized state control, liberalized economy, and a lingering electoral system designed to encourage gridlock in the congress by empowering the minority with a disproportionate occupation of seats.⁴⁹

1. Executive Branch

In the beginning of Aylwin’s administration there was great cohesion between the President, the Chilean elites, and the finance minister in setting public policy.⁵⁰ The Interministerial Committee on the Economy included the President, the Secretary of the

⁴⁷ Pinera, 227

⁴⁸ Joaquin Fernandois and Michael A. Morris, “Democracy in Chile Transition and Consolidation 1987-2000.” *Research Institute for the Study of Conflict and Terrorism*, March/April 1995, 10

⁴⁹ Frohmann, 241.

⁵⁰ Teichman, 84.

Presidency, the Minister of Finance, the head of the Central Bank, the Minister of the Economy, the Minister of Public Works, and the Minister of Labor. This committee was lead by Minister of Finance Foxely, who collaborated closely with the Minister of the Economy to develop macroeconomic policy for the administration.⁵¹ The successful insulation of the committee, combined with the pragmatic nature of Aylwin, compromised the president's preferences; appearing economically liberal contrary to his political alignment.

2. Legislative Branch

A legacy of the constitution enacted during the Pinochet regime, Chile's binominal-majoritarian electoral system requires two seats representing each and every district in the Senate and the Chamber of Deputies with an additional nine seats in the Senate permanently occupied (until 1997) by Pinochet appointees. In both houses the first seat of a district is won by the candidate with the majority vote. The second seat is filled by the party with the next highest proportion of the vote, unless the proportion of the votes for the party are twice that of as any other runner-up party, thereby granting the party both seats in the district. General Pinochet abided by the constitution, and within the constitution left rigid remnants of disproportionate right-wing power in the legislature. “The peculiar binominal electoral system was aimed at securing congressional representation of the right—a numerical minority—well beyond its share of the ballot.”⁵² The *Concertacion* had consistently gained the majority victories in every district for seats in both the house and Senate, but to no avail. The disproportionate seats held by the Alliance Party and the rigid constitution hindered any attempts at constitutional or legislative amendments, which require two-thirds majority vote and in some cases four-fifths of the votes in the legislature.

⁵¹ Teichman, 88.

⁵² Frohmann, 245.

3. Military

Aylwin's patient construction of institutions through the transition was discussed earlier as a key to the democratic success of Chile; however Commander of the Army General Pinochet's decision to abide by the constitution he had enacted also facilitated a successful transition to democracy. Pinochet was asked to resign as commander by president-elect Aylwin, yet he was said to have quoted his constitutional right to remain in command.⁵³ The military remained autonomous and insulated from the government, including civilian prosecution. Aylwin, known for his pragmatism, also respected the constitution and paid a great deal of attention in trying to amend it working through the available legal mechanisms.

Dealing The military during the Aylwin administration, still under the supervision of Pinochet, served as a distraction that diverted national attention toward legislative and constitutional reforms, thus leaving free-market reforms a tertiary concern. Much political attention was given to bringing justice to the human rights violations under the military regime. President Aylwin and the new democracy were concerned by the possibility of another military overthrow, since the military was virtually immune to civilian authority. Their funding came from the copper mines, their leadership came from Pinochet, and the disproportionate conservative wing in the legislature stood as firm opposition in any change in this arrangement. Historically, Latin American armies have acted autonomously within the state, and the Chilean democracy did not initially appear to be any different.⁵⁴

G. CHILEAN POLICY OUTCOMES

The Aylwin administration instituted a number of economic reforms that seem to run contrary to the political preferences of the president. Judith Teichman provides a list of successful free-market reform which Table 1 uses but also includes Carol Graham's research on the social programs that support and stabilize first generation market reforms.

⁵³ Fermano, 11.

⁵⁴ Brian Loveman, "Historical Foundations of Civil-Military Relations in Spanish America," *Civil-Military Relations in Latin America*, ed. David Pion-Berlin, (Chapel Hill, North Carolina: University of North Carolina Press, 2001), 246-274

To enumerate these free-market policies, Table 1 includes a numerical guide to economic reform delineated by John Williamson, in his article on the “Washington Consensus”. Williamson’s ten areas of policy reform as the criteria of successful market-oriented reforms: (1) fiscal discipline, (2) public expenditure priorities, (3) tax reform, (4) financial liberalization, (5) exchange rates, (6) trade liberalization, (7) foreign direct investment, (8) privatization, (9) deregulation, (10) property rights.⁵⁵

Neoliberal Reform	Effects	“Washington Consensus”
1990: tax reform to raise revenue	Revenue raised for social programs to further stabilize the Chilean economy.	2, 3, 9
1990: Established Fund for Solidarity and Social Investment	Local control of operations and funding	1,2,9
1991: tariff reduction from 15 to 11 percent	Moderate reduction limits social impact	3,5,6,9
1991: completed privatization of Chilean airline	Increased efficiency in the industry, better prices for consumers	8
1992: foreign investment restrictions loosened	Allowed private capital access to industry, including CODELCO	7
1993: announcement of remaining state owned companies to be privatized: except CODELCO (Chilean Copper Mines)	May not have been an implemented policy, but reflected neoliberal reform momentum.	8
1994: bill to break up CODELCO in division; non-mining division to be privatized	CODELCO remains as a source of income to the military	7, 8
1990-1994: bilateral trade agreements with United States and Mexico	President George Bush was able to visit President Aylwin in Chile developing a relationship between the nations to a potential bilateral tie with the United States.	6
Reforms were delineated from Judith Teichman and Carol Graham. Authors interpretation		

Table 1. Reforms Under Patricio Aylwin

⁵⁵ John Williamson, “What Washington Means by Policy Reform,” *Modern Political Economy Theory and Latin America Policy*, Edited by Jeffry Frieden, Manuel Pastor Jr., Michael Tomz. Westview Press: Boulder, Colorado. 2000. 18-23.

The list provided by Teichman left out social programs, high on President Aylwin’s policy agenda, which were successfully implemented. The additional revenue from tax reforms were used to fund social programs that provided primary school education to the most disadvantaged areas in the country as well as funded the Fund for Solidarity and Social Investment (FOSIS).⁵⁶ FOSIS can be counted among the neoliberal successes because it both “built local participation into its operations and limit(ed) the potential for centralized political control.”⁵⁷ The successful implementation of these social programs came from the willing compromise between government and private enterprise on profit tax.

H. ANALYSIS

Under what conditions do democratically elected left-wing parties successfully carry out free-market reforms? Free-market reforms are synonymous with neoliberal reforms or those considered part of the “Washington Consensus,” which, according to Robert Looney, is founded on three core concepts: imperfect information, individual freedoms, and the primacy of markets.⁵⁸ Looney argues that neoliberalism is founded on the freedom of individuals to seek their interests in a “societal institution” liberated of restrictions to provide the individual with price signals to adjust their preferences. This definition reinforces the assumption highlighting the importance of freedom and rational choice; subsequently liberating economic polices is dependent on institutions and the actors who have influence.

This chapter argues that international actors lacked significant influence in Chile’s economic reforms under President Aylwin, a unique scenario in Latin America considering examples of IMF-generated reforms in Brazil and Argentina. Most literature published on Chile’s economic success ignores President Aylwin’s free-market reforms in favor of the successful reforms of General Pinochet’s authoritarian rule and his team of economists, the “Chicago Boys.” However, Aylwin’s administration promulgated free-

⁵⁶ Carol Graham, *Safety Nets, Politics, and the Poor: Transitions to Market Economies*, (Washington, D.C.: the Brookings Institution, 1994), 43-44.

⁵⁷ Graham, 25

market reforms in an environment of distraction, democratic barriers, and transitional baggage. In fact, the successful reforms become more impressive in view of a culturally strong autonomous state, because the policy outcome reflected a compromise of the president's preferences.

President Aylwin successfully implemented free-market reforms whether or not they mirrored his preferences. His preferences were fixing the social issues of inequality, poverty, justice for human rights violations, and economic stability. However, these social programs and interests encountered immense institutional barriers, and resulted in degraded power and influence on policy outcomes. His loss of autonomy began with the insulation of his Interministrial Committee on the Economy, led by Foxely, which administered the executive branch of the government public policy. It was only through compromise and cooperation that committee was effective. The remnants of Pinochet's authoritarian regime created barriers to Aylwin's social programs. Institutional barriers included the political strength of right-wing congressmen in pacifying any success in constitutional or legislative reforms resulting from the disproportionate binominal-majoritarian electoral system for legislative seats. Military autonomy over funding robbed the state of copper revenue, and the international actors showed minimal concerns with the direction of the Chilean markets. Aside from informal institutions, Aylwin's economic preferences were also inhibited by the dynamics of the transition back to democracy, the continuing role of General Pinochet as Commander of the Army, and the international spotlight of justice for human rights violators.

⁵⁸ Robert Looney, "Neoliberalism" To be published in R.J.B. Jones ed., Routledge Encyclopedia of International Political Economy (London: Routledge, 1999)

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IV. BRAZIL

Brazil has the seventh largest economy in the world and is an important trading partner of the United States. In recent years trade relations have been little more than cordial, even though both countries are in favor of free-trade markets. Critical domestic markets within both countries have been protected and used against one another as leverage in trade talks. The United States protects its steel industry and orange juice producers by restricting Brazilian imports, and Brazil has slowed progress towards a Free Trade Area of the Americas. New concerns have arisen among U.S. policy makers with the inauguration of President Luiz Ignácio (Lula) da Silva, leader of the Brazilian Workers Party, who has been severely critical of U.S. foreign policy and economic strategies in the region. This criticism was clearly a part of his electoral campaign, but there were sincere concerns among U.S. policy makers that these critiques would translate into concrete policies once President da Silva took power.

Disregarding the rhetoric of campaign propaganda, U.S. concerns with Brazil stem from the possible policy shifts under Lula that may hurt its economy and the entire region. Investors tend to view criticism of U.S. economic policies as a leading indicator of a shift away from market reforms. This chapter argue that regardless of the political preference of the president, free-market or neoliberal economic reforms will still be the result of the contemporary Brazilian political process. This chapter will analyze Brazil's economic policies under President Fernando Henrique Cardoso, a successful left-of-center politician. His economic policies would prove him to be a pragmatic executive. The successful economic reforms initiated and instituted by Cardoso did not occur in a political vacuum. This chapter will demonstrate the impact that Brazilian state institutions had on these reforms.

This chapter will show how President Cardoso created institutions to successfully implement neoliberal reforms, yet did not have autonomous power to complete every step in the process. President Cardoso came to power with politically left ideals but turned around to commit Brazil to open markets. Cardoso's pragmatic policy agenda was met

with opposition toward the end of his rule, which forced compromise and cooperation on issues of “first generation” reforms.⁵⁹

Brazil was in a very unique situation when it elected Cardoso since it had a history of two failed heterodox economic policies since the return to democracy in 1985, and it was only beginning to see the fruits of the reforms that Cardoso himself had implemented as Finance Minister.⁶⁰ “Populism and economic nationalism were the very cornerstones of the system, which saw a continual, albeit uneven, distribution of entitlements and favors by the state.”⁶¹ The Jose Sarney administration (1985-1989) instituted a heterodox economic program that called for a wage, price, and exchange rate freeze; as well as a new currency to avoid deflation from the existing high interest rate.⁶² This *Cruzado Plan*, named after the new currency, was a failure after one year of limited success until hyperinflation shredded the currency. Riordan Roett, a political scientist from Johns Hopkins University, called the Cruzado Plan “an act of Hobbesian desperation given the fragmented nature of Brazilian federalism, weak political parties, and a high level of rent-seeking at all levels of government.”⁶³ The second failure of economic policy came under the President Fernando Collor de Mello who introduced another heterodox reform program resulting, as witnessed before, into hyperinflation and economic collapse.⁶⁴ Only after the impeachment of President Collor de Mello did Brazil take the first steps towards neoliberal reforms.

⁵⁹ Barbara Stallings and Wilson Peres define “First Generation reforms” as shorthand for policies of “import liberalization, domestic financial liberalization, capitol account opening, privatization, and tax reform.” This is a common term which is sometimes used synonymously with the “Washington Consensus.” However the Washington Consensus encompasses both first and second generation reforms. Some scholars prefer to segregate the neoliberal reform into the two generations to enhance their explanatory value by demonstrating necessary succession of reforms through phases. Barbara Stallings and Wilson Peres, *Growth, Employment, and Equity: The Impact of the Economic Reforms in Latin America and the Caribbean*, (Washington, D.C.: Brookings Institution Press, 2000), 202

⁶⁰ Riordan Roett, “Politics an Century’s End,” *Brazil Under Cardoso* (Boulder: Lynne Rienner Publishers, 1997), 24

⁶¹ Riordan Roett, “Brazil’s Protracted Transition to Democracy and the Market,” *Post-Stabilization Politics in Latin America: Competition, Transition, Collapse*, Carol Wise and Riordan Roett, ed., (Washington, D.C.: Brookings Institution Press, 2003), 205

⁶² Albert Fishlow, “The Real Plan,” *Brazil Under Cardoso*, ed. Susan Kaufman Purcell and Riordan Roett, (Boulder: Lynne Rienner Publications, 1997), 47

⁶³ Riordan Roett, “Brazil’s Protracted Transition to Democracy and the Market,” 200.

⁶⁴ Roett, 200

Under Cardoso, Brazil successfully instituted neoliberal reform policies that at first glance seemed to run contrary Cardoso's academic socialist background. What motivated Cardoso to support orthodox economic programs given his historical alignment with the political left? How could these policies be so successful given the weakness of political structures in Brazil's new democracy? Was the United States as concerned with Cardoso's election as they are with Lula's presidency?

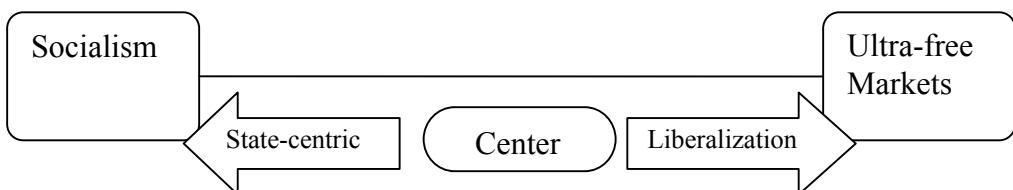


Figure 2. Economic Policy Continuum

A. ACTORS AND PREFERENCES

This section will examine three areas, starting with the focal point of the chapter, President Fernando Henrique Cardoso. The detailed account of Cardoso as an individual and eventual executive will be followed by an examination domestic actors, who either cooperated with the economic reforms for their own benefit, or were an obstacle to reform. Finally, international actors will be examined for their impact on Brazil's neoliberal policy outcomes.

1. Head of State

Fernando Henrique Cardoso was a president who won an enormous amount of support from his economic agendas, as evidenced in his election to two terms as president, the second term only as a result of a constitutional amendment allowing it. Despite his remarkably pragmatic term in office, Cardoso began his academic career as a politically leftist scholar, Cardoso did not publicly associate himself with the communist party, but early in his career he wrote for the journal *Fundamentos*, which was widely known as a communist periodical.⁶⁵ In an interview by Ted Goertzel, a Communist Party

⁶⁵ Ted G. Goertzel, *Fernando Henrique Cardoso: Reinventing Democracy in Brazil*, (Boulder, Colorado: Lynne Rienner Publishers, 1999), 7-8

member and friend of Cardoso says, “*Fellow traveler* is a good term to describe Fernando Henrique’s relationship to the party, although ‘in an intellectual sense.’”⁶⁶ Goertzel uncovers an article review written by Cardoso for the *Fundamentos*, in April 1952 which encapsulates this chapter’s point of portraying Cardoso as having a solid socialist background. “Cardoso writes, ‘capital is formed by the exploitation of the labor force of the majority of the population for the benefit of the few and at the cost of general impoverishment.’”⁶⁷ Cardoso felt that capitalism was the formal suppression of people by the wealthy few businessmen and is not in the interests of the people to inspire their support. Cardoso would also assist in assembling a group of renowned Brazilian scholars to critically study and discuss interpretations of Karl Marx works. Even his doctoral dissertation took a Marxist perspective on the role of capitalism and slavery in Brazil.⁶⁸ The 1964 coup d’etat spotlighted the political divisions at universities all over Brazil, where conservatives seized the opportunity to repress communist and socialist parties or forums. Cardoso took this opportunity to continue his work abroad. While in exile, Fernando Henrique co-authored his most famous work with Enzo Faletto, *Dependency and Development in Latin America*, a seminal work in the field of dependency theory.⁶⁹ After returning from exile Fernando Cardoso spent the 1970s continuing to write about dependency theory, studying and writing about urban problems, and exploring the alignment of political forces in Brazil.⁷⁰

Cardoso was elected senator of the São Paulo district, and represented many special interests that were in favor of protectionism. This alignment to state-centric policies place him the opposite side of the prominent Senator Roberto Campos—a free-market, neoliberal advocate—who prescribed policies of privatization, fiscal stability, and decentralization that Cardoso later also advocated.⁷¹ Cardoso would later become

⁶⁶ Goertzel, Fernando Henrique Cardoso: Reinventing Democracy in Brazil, 7

⁶⁷ Goertzel, 8

⁶⁸ Goertzel, 17. Dialectical sociology is described as the study of the “concrete totality” of a social system, a difficult metaphysical concept that Marx took from Hegel. 25

⁶⁹ Fernando Henrique Cardoso and Enzo Faletto, *Dependency and Development in Latin America*, translated by Marjory Mattingly Urquidi, (Siglo Veintiuno Editores, SA, 1971; reprint, Berkeley: University of California Press, 1979), 175.

⁷⁰ Goertzel, *Fernando Henrique Cardoso*, 55-56

⁷¹ Goertzel, 85-86

the finance minister under President Franco, and would assemble a team predominately comprised of U.S.-trained economists and former civil servants responsible for authoring the *Cruzado Plan* in 1986. This team would develop an economic agenda to cut government spending by \$6 billion, tighten tax collection, and resolve financial relationships between the federal government and deeply indebted state governments.⁷² The *Real Plan* also pegged the new currency to the dollar to stabilize hyperinflation. The success of the *Real Plan* catapulted him into the presidency, where he continued a neoliberal policy agenda.

President Cardoso took office ten years after the fall of the military regime, coming to the conclusion that Brazil had a choice between two strategies for development. The first was ‘populist developmentalism’ that mobilizes the population in support of state-centric ‘redistributionist policies.’⁷³ The alternative was “associated developmentalism, which works with multinational corporations and agencies.”⁷⁴ Goertzel writes that Cardoso felt the left needed to understand they had lost the political debate over development strategy, while the military in power uses the first strategy, but needed to focus its energy on democratization.⁷⁵

Fernando Henrique Cardoso’s administration, which included the finance minister Pedro Milan, developed a privatization and trade liberalization program of “six far-reaching amendments” to the 1988 constitution. “The changes included provisions to allow foreign-owned companies to invest in mineral and oil extraction, to offer national treatment to foreign firms, to allow both Brazilian and foreign firms to provide telephone and data transmission services, to allow foreign companies to compete in coastal shipping, and to allow domestic and foreign entities to distribute natural gas to households and industries.”⁷⁶

Unlike other left-of-center presidents in Latin America, Fernando Henrique Cardoso was the protagonist of neoliberal reforms. Instead of being forced to adopt

⁷² Roett, “Brazil’s Protracted Transition,” 207

⁷³ Goertzel, 70

⁷⁴ Goertzel, 70

⁷⁵ Goertzel, 70

⁷⁶ Roett, “Brazil’s Protracted Transition,” 208

neoliberal reforms by other domestic or international actors operating within the institutional arrangements inherited from the previous military dictatorship, Cardoso became a pragmatic president whose personal preferences became secondary to effective economic policies. Cardoso honestly believed and advocated that neoliberal reforms, as represented in the ‘Washington Consensus,’ would benefit the Brazilian people.

2. Domestic Actors

Before and after Cardoso’s inauguration, Brazil’s domestic politics was governed by minority coalitions. Weak and fragmented political parties created an environment of fragile governing conditions. Domestic elites were either protected or benefited from inflationary conditions, and formed small but powerful coalitions opposed to policies of neoliberal reforms.⁷⁷

In the beginning of Cardoso’s presidency the administration possessed a strong and legitimate political coalition, which resulted from the success of the Real Plan and overwhelming election victory.

a. Legislature

The preferences of the legislature cannot be pinned down to a specific agenda. Congress is as politically diverse as the country. Another reason an agenda cannot be clearly identified is due to the fragmented political party system. A clear majority is only achieved through minority coalition building, which invariably leads to sacrifices of preferences through compromise. The legislature’s preferences are most effective and influential when used to destroy policy initiatives vice supporting them. Giving disproportionate power to narrow social interest groups influences policy, but more importantly weighing in or policy reform.⁷⁸

⁷⁷ Philippe Faucher, “Restoring Governance: Has Brazil Got It Right (At Last)?, *Markets and Democracy in Latin America: Conflict or Convergence?*, ed. Philip Oxforn and Pamela K. Starr, (Boulder: Lynne Rienner Publishers, 1999), 105.

⁷⁸ Peter R. Kingstone, “Constitutional Reform and macroeconomic Stability: Implications for Democratic Consolidation in Brazil,” *Markets and Democracy in Latin America: Conflict or Convergence?* Ed., Philip Oxforn and Pamela K. Starr, (Boulder: Lynne Rienner Publishers, 1999), 134

b. Political Parties

Brazilian political parties have a historical foundation of being easily manipulated by a strong state or politically strong elites. Weak party institutions and its lack of accountability allow politicians to abuse the party's individual political careers.⁷⁹ Philippe Faucher perfectly captures the difficulty with identifying a unifying common preference.

At the political level, failure resulted from a weakly institutionalized party system and the absence of an aggregative agenda, which exacerbated the fragmentation of interest representation in Congress and thereby limited the government's ability to build stable majority coalitions.⁸⁰

Political parties in Brazil have an identity crisis. The dilemma is the struggle between who defines the party; the politician or the party. The party is identified by the candidate running for election, because the party does not finance them and have little impact in the nominating process. Power the party may possess originates from politician's autonomy and not an institutional norm or constitution. The Worker's Party (PT) — the statist left wing popular party—has been the only ideologically consistent major party and is the only party that demonstrates “party-line voting.”⁸¹

c. Labor Unions

Labor unions were one of the most protected institutions during the economic crisis years. Labor unions by design are the aggregated preferences and interests of its members, and in particular the unions represented the growing middle class. The heterodox policies protected the workers through its price and wage freezes, clearly defining their preferences. An example of union's preferences: after the Cruzado Plan of 1986, “thousands of volunteers rampaged though the streets to check prices,” because once the program began it was in the interest of the middle class to ensure public compliance and was not impacted by distributional costs.⁸² Once the plan failed to stabilize inflation and prices were revalued the government was paralyzed and failed to

⁷⁹ Scott Mainwaring, “Brazil: Weak Parties, Feckless Democracy,” *Building Democratic Institutions: Party Systems in Latin America*, ed. Scott Mainwaring and Timothy R. Scully, (Stanford: Stanford University Press, 1995), 387.

⁸⁰ Faucher, 106

⁸¹ Kingstone, 141

⁸² Faucher, 117

implement necessary fiscal reform. The middle class in labor unions were better off than the poor who were dramatically affected by inflation and the wage freezes that guaranteed class wages expanding the distributional gap.

3. International Actors

International actors like the IMF have held that neoliberal economic policies are the keys to a growing economy, but more importantly view adherence to these policies as a way to reassure lenders and investors they will get their money back.⁸³ Brazil has always been attractive as a market for international investors, which has led to a level of tolerance toward its policy setbacks and incoherence.⁸⁴ For example, in 2001 the IMF offered an additional loan, \$30 billion total with \$6 billion given in 2002 and the rest given after the election in 2003; in an effort to guarantee the new administration adherence to the provisions and fiscal targets.⁸⁵ Leniency is not often given to other Latin American countries required to insulate central banks or use create currency boards, but the fear of a Brazilian default is also incentive to be tolerant.

B. INSTITUTIONAL FRAMEWORK

Political framework in Brazil was less than conducive to implementing neoliberal reforms, yet the need for economic success was greater than in Chile.

1. Constitutional framework

Brazil is a presidential democracy where the executive is selected by majority vote while the congress is selected by proportional representation. This institutional arrangement and historical voting attitudes have led to a weak political party system.⁸⁶ Proportional elections facilitate and cater to special interests. If one party is not completely aligned with a candidate or voter, that individual can leave or create a new

⁸³ Roett, “Brazil’s Protracted Transition,” 211

⁸⁴ Kingstone, “Implications for Democratic Consolidation in Brazil,” 136

⁸⁵ Roett, “Brazil’s Protracted Transition,” 211

⁸⁶ Scott Mainwaring, “Introduction,” *Building Democratic Institutions: Party Systems in Latin America*, ed., Scott Mainwaring and Timothy R. Scully, (Stanford, California: Stanford University Press, 1995), 12

party. The advantage of a proportional system is every minority has a voice in the democracy, but there is limited benefit to being loyal to a party.

a. Executive Branch

Cardoso had a very difficult task in trying to aggregate support for his economic agenda. As Philippe Faucher points out, widespread partrimonialism and clientelism, inadequate resources, and an erosion of professional staffs weakened the state.⁸⁷ The process of implementing reform to improve this bleak scenario was more of a balancing when trying to collect a majority of support from special interest groups, legislators, and state's governors in order to implement policy. In the beginning of Cardoso's presidency the momentum of the Real Plan pacifying inflation collected support from the population and those politicians popularly supported, but political elites who were protected or benefited from an inflationary environment remained in opposition.

The selection of key economic leaders was a way for President Cardoso to signal his commitment to economic reform. As Roett argues, "The appointment of Arminio Fraga, a Princeton-trained economist, as the new central bank president quickly restored international investor confidence and domestic support for continued reform."⁸⁸ Fraga had worked closely with financier George Soros, and was known by Wall Street's investors, traders, and analysts; any policies he'd introduce would be viewed as reliably market-friendly.⁸⁹ Cardoso had used his executive appointments to solidify legislative alliance, which grew to a fairly consistent 60 percent support from congress.⁹⁰

b. Legislative Branch

The Brazilian congress had ten political parties represented during the 1988 constitutional reform.⁹¹ Such a varied representation requires coalitional behavior for legislation to be passed, which waters down effective policies satiating individual congressmen's preferences. As well, without a clearly defined majority, opposition tends

⁸⁷ Faucher, 112

⁸⁸ Roett, "Brazil's Protracted Transition," 201

⁸⁹ Roett, "Brazil's Protracted Transition," 201

⁹⁰ Kingstone, 147

⁹¹ Faucher, 108

to have a paralyzing effect on policies. The military regime's impact on the legislature left a legacy of "widespread corruption, institutionalized violence, and an under-funded and ineffective judicial system..." The legacy of clientelism among the political elites was directly opposed to any stabilization programs, especially if it impacted the balance of power. There was limited room for compromise away from institutionalized protection granted by the state from the military regime through the transitional government's heterodox economic policies. Because of fragmented political representation and the absence of a clear, stable, and coherent majority in congress until 1994, the Brazilian presidents were never in a position to obtain the clear vote of support necessary to implement the "transitional costs of stabilization on a skeptical population."⁹²

2. Informal institutions

Cardoso's program suffered some early defeats but also demonstrated a number of successes, thanks to a clever combination of the use of democratic tools of negotiation and "traditional" political practice based on the selective allocation of funds and state patronage.⁹³

a. Social Inequalities

Privatization and trade liberalization proved to have a negative impact on the economy and markets in general until the reforms stabilized.⁹⁴ Unfortunately it was the poor, unemployed, and lower classes of society who suffered most by these reforms. In a political environment as populist as Brazil, the poor and downtrodden become a political force. But there is another dimension to Brazilian social poverty, and that is the enormity of the situation that attracts international attention as well as domestic. Of the many social inequalities, education and the distribution gap had arisen as the dominant obstacles to neoliberal reforms.

As of 1997 only 37 percent of Brazilians between the ages of sixteen and eighteen were enrolled in secondary schools and approximately half of the labor force

⁹² Faucher, 108

⁹³ Roett, "Brazil's Protracted Transition," 208

⁹⁴ Przeworski, *Democracy and the Market*, 138-140

had minimal to zero formal schooling.⁹⁵ Rigid labor institutions were formed early in Brazil's history in an effort to protect workers from economic hardships during the state-directed industrialization. The impact of economic reforms on labor institutions will lead only a few, the one with educations, to take advantage of the new opportunities, thereby increasing the inequalities of employment and income.⁹⁶ It is from these social inequalities, rigid institutions, and state-centric social policies of protection that led to the 1988 constitution stipulating the transfer of federal tax revenues to the "states and municipalities without a concomitant transfer of responsibility for the implementation of social policy."⁹⁷

President Cardoso had built a solid foundation of support from the population with his Real Plan, which helped stave off increased poverty and inequality by dousing hyperinflation. But his quest for social equality did not end there. A true socialist, his social agenda was bent on reforming education, employment, health care, agriculture, sanitation, housing, and social security. However, the twist to Cardoso's social agenda was his administration's intent for all reforms to be innovative, decentralized, and cost-efficient. John Williamson's "Washington Consensus" embraces Cardoso's social agenda with the public expenditure and property rights sections of reforms.

C. POLICY OUTCOMES

When Cardoso took office there were eighteen political parties represented in congress, each "valuing patronage over any ideological position."⁹⁸ The institutional framework of weak politician accountability to their respective political party, proportional electorate, and patronage and clientelism destroyed the legislature's effectiveness and proved to be too big of a barrier for Cardoso to overcome, especially after his initial appointment's guaranteed loyalty expired and economic crisis ensued in

⁹⁵ Amaury de Souza, "The Social Agenda at Century's End," *Brazil Under Cardoso*, ed. Susan Kaufman Purcell and Riordan Roett, (Boulder: Lynne Rienner Publications, 1997), 65

⁹⁶ Souza, 65-66

⁹⁷ Souza, 73

⁹⁸ Kingstone, 141

Asia and later in Latin America. Cardoso experienced early defeats by the congress on social security reforms, a much needed reform for fiscal health. With the lessons of unsuccessful heterodox policies, the legislature still supported a minimum wage hike, and exemptions for farmers from monetary corrections.⁹⁹ Cardoso's constitutional reform agenda for privatization, tax system reform, administrative reform, political institution reform, and social security reform had a bleak outlook against the overwhelming legislative patronage obstacle.

In realizing the potential for bitter defeats on all agenda items, Cardoso shifted his coalitional approach and went on the attack. He attacked both the conservative elites who were protected as well as his political strength from the left—accusing them of ‘stupidity’—gaining again popular momentum confronting special interests on both sides of the spectrum on behalf of the people.¹⁰⁰ In light of the difficulties, Cardoso succeeded in June of 1995 when the Brazilian congress voted to partially liberalize the state oil monopoly, Petrobras, although its powerful unions were deeply involved in other parts of the economy and presented a formidable obstacle.¹⁰¹ This decision came on the heels of the Real Plan, and was implemented only six months after Cardoso’s inauguration.

Cardoso had successfully implemented a constitutional reform extending the single term limit for presidency into two terms. This successful reform to the institutional framework was ideally argued to allow Cardoso a longer period of time to complete his economic reform agenda. Again, creditability from easing inflation and other social programs legitimized his constitutional reform. However, hindsight has scholars make the point that he wasted his political momentum and resources on this amendment which could have been allocated to his economic agenda. After the fiscal crisis that started with the Mexican default and suspending foreign capital, as contagion spreading throughout the region, Cardoso spent much of his political capital implementing emergency strategies to protect what progress he had made, and not on continuing with reforms.

⁹⁹ Kingstone, 149

¹⁰⁰ Kinstone, 150-151

¹⁰¹ Roett, “Brazil’s Protracted Transition,” 208

Unfortunately the success of Cardoso's first term was no guarantee for the success of his second term in office, which to say the least, was disappointing. Following the currency devaluation in 1999, after the real to dollar peg was replaced by a floating exchange rate, Cardoso's administration concentrated on retaining the reforms made during the first term, all but abandoning any further reforms. "For example, no progress was made to liberalize labor markets, to reform the tax system, to modernize the judiciary, or to continue with the civil service reforms that had been initiated."¹⁰²

As for Cardoso's social agenda, he successfully amended the constitution earmarking more funds proportional to student enrollment. However, compromise in passing the legislation through congress 'axed' any reform to middle-class subsidization of higher education, which is important when "80 percent of the education budget is spent on Federal universities that accounts for only 22 percent of overall university enrollment."¹⁰³ The rest of Cardoso's social agenda received mixed support from congress, and the only true success was the constitutional amendment on education and two bills that bolster taxation on unproductive land and accelerate land expropriation.

In the end Fernando Henrique Cardoso successfully implemented reforms in key industries like oil, energy, and telecommunications; as well as good governance reforms for presidential term extensions and educational revenue reform. However, he failed to fix the tax system, social security, and civil service.

Table 2 itemizes free-market policies enacted under Cardoso's administration. Specific policies are extracted from secondary sources written by Albert Fishlow, Riordan Roett, and Ted Goertzel. Table 2 also includes this author's explanation on the affects of the reforms and a numerical guide that addresses specific area(s) of each reform delineated by John Williamson, in his "Washington Consensus" article, ten categories, or "policy instruments," that constitute neoliberal ideals. Williamson's ten areas of policy reform as the criteria of successful market-oriented reforms: (1) fiscal discipline, (2) public expenditure priorities, (3) tax reform, (4) financial liberalization, (5) exchange

¹⁰² Roett, "Brazil's Protracted Transition," 210

¹⁰³ Souza, "The Social Agenda at Century's End," 76

rates, (6) trade liberalization, (7) foreign direct investment, (8) privatization, (9) deregulation, (10) property rights.¹⁰⁴

Neoliberal Reform	Affects	“Washington Consensus”
1995: Brazilian oil monopoly, Petrobras, is partially privatized	An increased efficiency and competitiveness. The existing institutions (over powering labor unions) are being impacted by a successful and powerful president.	8,9
1996: state tax on exports eliminated	A new view of importance toward foreign trade.	3,6
1996: Curriculum and level definitions reformed in primary and secondary schools	Educational reforms better prepare the children for future developments and progress.	1,2
1997: civil service reform, an increase in taxes, a budget cut, and a constitutional amendment granting the federal government permission retain a portion of revenues	This reform was in reaction to the Asian financial crisis, stabilizing the economy	1,2,3,4
1996: constitutional term limits	In theory would have afforded Cardoso more time to continue reforms	
1996: telecommunication privatization	Allowed foreign investment and removed the state from control	8
Reforms were delineated from Riordan Roett, Albert Fishlow. Authors interpretation		

Table 2. Reforms Under Fernando Henrique Cardoso

D. ANALYSIS

As Laucher points out, economic stabilization reforms rely on the leader's ability to design an appropriate agenda that “fits the nature and quantity of available political support;” or the institutional framework. The institutional framework takes into account the preferences and interest of actors and how they group together. Procedures and norms for conducting policy reform affected Cardoso’s ability to implement his reform

¹⁰⁴ John Williamson, “What Washington Means by Policy Reform,” *Modern Political Economy Theory and Latin America Policy*, Edited by Jeffry Frieden, Manuel Pastor Jr., Michael Tomz. Westview Press: Boulder, Colorado. 2000. 18-23.

agenda, while his preferences constrained possible continued indexation of prices and wage.

The political costs of maintaining the indexation polices outweighed the minimal benefits to the middle class, who wanted complete protection, but by the Collor administration, there was no class unaffected by the economic instability. Politically, neoliberal reforms rested on two classes of individuals, the poor and businesses.¹⁰⁵ The indexation of the past solidified the middle class and unions' preferences for nothing less than state guarantees of protection. The political elite also benefited from inflation and kickbacks from those protected by the heterodox policies. The poor and businesses, on the other hand, stood to gain more through a stable economy.

Cardoso had realized this, although however important his alignment to social programs, he appreciated the efficiency and effectiveness of an open market, fiscal discipline, and export led development. Cardoso advocated neoliberal reforms, which is different from other left-of-center presidents. He was influenced by the continual failure of heterodox policy and by his knowledge of Marxism, which believes socialism occurs only after capitalism fails, and not before. As an educator he published many works for communist periodicals as well as extensive literature on the *dependency theory*. However, at the end of the day, Cardoso was pragmatic with his policy preferences, and the answer to Brazil's economic fiscal crisis was not default or state intervention but policy reforms toward market liberalization and good governance.

Cardoso's first term started out with minimal success until the second anniversary of the Real Plan, when it was realized that despite the continued low level of inflation, Cardoso had failed to complete his constitutional reform agenda. Legislative clientelism and patronage, weak and ineffective political parties, and politician autonomy created too large an obstacle for Cardoso to completely overcome. He successfully implemented reforms in key industries like oil, energy, and telecommunications. The rest of his administration's tenure was spent protecting his reforms and protecting Brazil from international economic crises.

¹⁰⁵ Kingstone, 138

Lula will have a similar balancing act, because lessons learned prove neoliberal reforms provide economic stability and international investment. But the institutional framework that Cardoso faced still exists, with an exception. Lula faces two additional institutional factors that Cardoso did not. First, the IMF pressure, which once supported Cardoso, will now try to coerce Lula to continue fiscal discipline and neoliberal reforms. Secondly, Lula's ideological accountability is to the PT, which Cardoso escaped. Lula may have to toe the party-line until he is free of the re-election candidacy. As it stands now, Lula has disapproved a minimum wage hike—as Cardoso did—and has reassured the IMF and the international community of its intent to honor its debts, a positive outlook for now.

V. CONCLUSION

Democratically elected presidents are rational actors who seek to maximize their power, influence, popularity, and legacy. Unless an election is looming, presidents set their political agendas on their preferences and interests. Left-wing presidents in Latin America are allied closely to socialists and communists whose economic preferences are state-centric. However, presidents who are left-of-center possess the ability to implement successful neoliberal economic reforms, which are characterized in this thesis as those reforms represented by the “Washington Consensus.” Two scenarios exist where left-of-center presidents will implement free-market reforms.

The first scenario is when the left-of-center president does not have interests or preference toward liberalism but is overwhelmed by institutions that are. Lack of neoliberal preferences could either be politically economic loyalty to the left or low agenda priority due to other more pressing issues (for example, democratic transition, internal civil disruptions, etc.). The president’s preferences are no less important to the state or this thesis; it needs to be clear that in a democracy the president’s agenda is not always final. It depends on the institutions that exist. Institutions that represent actors grouping their preference or political procedures and norms utilized make policies.

The second scenario for a left-of-center president that successfully implements neoliberal reforms stems from their political agreement with the efficacy and effectiveness of neoliberal economic reforms. This is labeled as the ‘pragmatic president’, whose preferences are dictated by the policy and benefits to the country, vice political loyalty. The pragmatic president either politically prioritizes social concerns and issues over the party-line, or lacks party accountability and is autonomous to execute personal preferences. Institutions in this case who are in favor of neoliberal reforms will support and collate their influence to support the president, and the opposition, whether from the left or right, will create obstacles to force concessions or abandonment of issues.

Neoliberal economic reforms (policy outcomes) result from actors aggregating their preferences, and rationally seeking those interests in an institutional framework as long as the benefits outweigh the cost involved in the process. Costs that deter an actor

from seeking interest could be political or literally resource dependent. Every actor makes a cost-benefit analysis, rationally maximizing its utility. A congressman may receive more utility by compromising on an issue, saving his resources for a higher-priority item.

The United States is deeply invested throughout the world and the scholarship on globalization is extensive, which does not bear repeating. However, the U.S. economy and investors become directly impacted by the elections of presidents in the developing countries. These countries lack the deepened institutions that developed countries do, making them and their trade relations vulnerable to political change. This vulnerability is even more sensitive when a left-of-center politician is elected into office. Developing countries predominantly require additional democratic consolidation and economic liberalization, and the election of a left-wing radical could undermine progress made. Progress that had already suffered transitional costs and those social classes would be impacted again when reverted. It is in the best interest of the developing country and the United States that orthodox economic policies continue.

Fragile democracies and the intricately woven web of markets emphasize political concern when a developing country elects a communist, socialist, or politically left president. This thesis demonstrates that you can't judge a crop by its weeds. The institutions feed and nurture policy outcomes with their preferences and procedures. The importance of this thesis was to encourage a detailed examination of the institutions of a developing country that has recently elected a potential threat to neoliberal progress. Assumption and judgments must be made for politicians to act, but research and follow-through with institutional details will reveal the true nature of a country's political economy. This thesis used Chile under President Patricio Aylwin and Brazil under President Fernando Henrique Cardoso as examples.

President Aylwin succeeded General Pinochet by popular election, democratically overthrowing the military regime. The unification of the political parties opposed to Pinochet had successfully nominated the victor, and created a new institution of a two-party environment. The Concertacion was politically left-of-center, absorbing the communists and socialists with the Christian Democratic Party. However, a rigid

constitution and remnants of the military regime existed: a disproportional congress, General Pinochet remained commander of the armed forces, and human rights violations by the military were overlooked. Amid all these distractions, Aylwin's preferences were fixing the social issues of inequality, poverty, justice for human rights violations, and economic stability. These social programs and interests encountered immense institutional barriers, and resulted in degraded power and influence on policy outcomes. This exemplifies the first scenario, when the president is led to neoliberal reforms instead of them being part of their agenda.

Most literature published on Chile's economic success overshadows President Aylwin's free-market reforms with the successful reforms of General Pinochet's authoritarian rule and his team of economists, the "Chicago Boys." However, Aylwin's administration promulgated free-market reforms in an environment of distraction, democratic barriers, and transitional baggage. Policy reforms included tax reforms, privatization of industries, tariff reduction, and deepening of institutions that support democracy.

While Aylwin was an example of institutions overwhelming his political alignment on the issue of market reforms, President Fernando Cardoso is the example of the 'pragmatic president.' Cardoso was an educator and avid socialist before entering politics. He wrote and published works for communist journals and books highlighting the repressive ways of capitalism, and how it benefited the few at the expense of the many. But Brazilian economic failures with heterodox economic policies, and the understanding that socialism is found on the other end of capitalism and not achieved by social revolution, led Cardoso to become an advocate of neoliberal reforms.

Cardoso took office on the momentum of an economic program that fixed the Brazilian hyperinflationary environment. However, some institutions arranged for political elites and labor unions to benefit from an inflationary economy. Cardoso's economic reform agenda encountered significant opposition by institutions of patronage and clientelism in the legislature and among the state governors. Cardoso was able to successfully navigate the treacherous institution, achieving policy reforms in the state-monopolized oil industry and in public expenditures toward schools.

Cardoso was unable to continue economic stabilization reforms, despite being elected to a second term. Economic crises in Asia and the fiscal defaults within its region forced Cardoso to spend more political capital on retaining the reforms already in place. Fernando Cardoso succeeded in leading Brazil toward a more open market, but institutions prevented completion of consolidating neoliberal policies. Brazil remains well behind its neighbors in economic liberalization.

Economic institutionalism methodology requires the researcher to delve into details. Within these institutional details lies the ability to confidently predict policy outcomes. This methodological research should be continued on developing countries with democracies, either for historical explanation or in present political contexts. Case studies can be further discriminated by democracies requiring consolidation, or have fragile institutions, because in this globalized economic environment the most turbulent democracies tend to cause the most disruption in market balances. Theoretically, rational institutionalism is not the end-all answer, but fairly reflects the realities of political economies.

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